

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

THE BERKSHIRE GAS COMPANY

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) D.T.E. 04-52
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REPLY COMMENTS OF THE BERKSHIRE GAS COMPANY

On May 14, 2002, The Berkshire Gas Company (“Berkshire” or the “Company”) filed its first Price Cap Mechanism (“PCM”) Plan rate adjustment pursuant to the performance-based rate plan approved by the Department of Telecommunications and Energy (“DTE”) in The Berkshire Gas Company, D.T.E. 01-56 (2002). Berkshire filed updated tariffs for effect September 1, 2004 that reflected an increase in its normalized base revenue of 0.92 percent pursuant to the established rate adjustment formula in the PCM plan. The proposed adjustment included two proposed “exogenous factor” adjustments, namely for certain equipment investments necessary to comply with the mandatory service quality reporting standards of the Department (See D.T.E. 99-84) and investments associated with security enhancements implemented in response to mandates following the events of September 11, 2001.

The Department issued a Notice of Filing and Request for Comments dated June 9, 2004. Pursuant to such Notice, initial comments on the Company’s PCM filing were due June 30, 2004 and reply comments are due July 12, 2004. In addition, on June 21, 2004 the Department issued its first set of information requests in this proceeding. The Company filed its response to such requests on July 2, 2004. On June 30, 2004 the Attorney General of the Commonwealth of

Massachusetts (the “Attorney General”) filed his initial comments in this proceeding. These reply comments of the Company respond to the Attorney General’s initial comments.

The Attorney General raised limited substantive comments and, on a procedural matter, noted that the Company’s initial PCM filing should be carefully reviewed to ensure compliance with the requirements of the Department’s directives in D.T.E. 01-56. The Company notes that its initial PCM filing was presented in a form familiar to the Department from other performance-based rate plans. In addition, as noted, the Company has presented responses to the eight information requests issued by the Department. The Company respectfully submits that an appropriate and efficient procedural schedule has been established.

In terms of substantive concerns, the Attorney General has raised only two issues. First, the Attorney General commented on the consistency of the originally submitted rate design and certain continuity limits imposed by the Department in D.T.E. 01-56. The Company’s response to Information Request DTE 1-2 has addressed this concern. The Company submits that this revised rate design analysis fully complies with the directives of D.T.E. 01-56.

Second, the Attorney General notes that Berkshire’s annual filing had not discussed whether customers were entitled an exogenous factor rate reduction to reflect any perceived benefit for additional depreciation allowances available under a recent amendment to the Internal Revenue Code, namely §168(k) - Special Allowance for Certain Property Acquired After September 10, 2001 and Before September 11, 2004 (“Bonus Depreciation”). The Attorney General referenced the testimony of Massachusetts Electric Company in docket D.T.E. 03-124, which proceeding involves the Department’s consideration of a proposed distribution rate change pursuant to the Rate Plan Settlement dated November 29, 1999 (“MECO Rate Plan”) approved

by the Department in connection with the merger of Massachusetts Electric Company (“MECO”) and Eastern Edison Company. Massachusetts Electric Company et al, D.T.E. 99-47 (2000).

By way of background, MECO’s November 21, 2003 Exogenous Factor Filing in docket D.T.E. 03-124 included testimony in support of an adjustment for normalizing the “book” and “tax” depreciation rates to reflect the availability of the new deduction for Bonus Depreciation. MECO acknowledged that the effect of Bonus Depreciation on eligible assets is “temporary and will reverse to zero over the life of the asset being depreciated.” Testimony of Michael D. LaFlamme, D.T.E. 03-124, p. 6. MECO noted, however, that, in the near term, it would “experience an economic benefit related to a lower current, or cash, income tax liability.” Id. p. 7. Accordingly, MECO proposed to treat this “benefit” as an exogenous factor that reduced its annual revenue requirement.

Berkshire notes that MECO’s proposed exogenous cost adjustment for Bonus Depreciation may well be consistent with the terms of the MECO Rate Plan. Berkshire submits, however, that its approved PCM Plan is fundamentally different than several relevant aspects of the MECO Rate Plan. Accordingly, the Department should either find that an exogenous factor adjustment for Bonus Depreciation is not appropriate pursuant to the PCM Plan or, alternatively, reflect such adjustment by clarifying and confirming that the terms of the PCM Plan allow adjustments for all such legislative or regulatory adjustments to rates that reflect changes to tax requirements that are beyond the control of the Company.

First, as noted in the Company's response to Information Request DTE 1-8, Bonus Depreciation merely reflects a temporary timing difference between book income and taxable income. Over the life of these qualified assets eligible for bonus depreciation, the total tax depreciation taken will equal the original cost and, therefore, the Company will not incur a net

tax benefit as a result of this legislative change. The tax change is similar to prior tax law depreciation changes such as the introduction of ACRS and MACRS tax depreciation methods. This revision merely modifies the timing of tax recognition of income and expenses but does not create a net tax benefit like a change to tax rates which could create a permanent net tax benefit or expense.

More importantly, in order to qualify for additional first year tax depreciation deductions, eligible plant must have been placed in service between the period September 11, 2001 and September 10, 2004. Since plant is a rate base item and the Company's distribution rates only reflect rate base in service as of December 31, 2000 (the end of the test year for D.T.E. 01-56), this change in depreciation schedules should not be reflected in the Company's distribution rates nor considered an exogenous cost.

The Company has noted that historically, "book" depreciation has been used as the cost component in establishing rates, and was used in the Company's past rate cases including D.T.E. 01-56. Changes in methods of calculating tax depreciation are generally not a component of developing the depreciation expense used in determining a cost of service requirement. Accordingly, for this additional reason the Company does not believe that it is appropriate to include a "tax" depreciation modification as an exogenous cost. Any change in ratemaking practices adopting changes to rate base would be a substantial departure from the principles underlying the approved PCM Plan.

Second, there are distinctions in terms of the definition of exogenous costs between the MECO Rate Plan the and PCM Plan. The terms of the MECO Rate Plan established several "phases" to that plan, including the so-called "Rate Cap Period", i.e., from 2002 to 2005. The filing cited by the Attorney General in his initial comments is governed by the conditions of the

Rate Cap Period. During the Rate Cap Period, MECO's distribution rates are frozen subject only to certain exogenous factors and service quality adjustments. Massachusetts Electric, D.T.E. 99-47. No other cost-based adjustments are permitted. During this Rate Cap Period, exogenous costs adjustments were allowed for "the effects associated with any changes in the federal, state or local rates, laws, regulations, or precedents governing income, revenue, sales, franchise, or property taxes if the accounting and tax changes individually affect MECO's costs by more than \$1 million per year." Id., (emphasis added); MECO Rate Plan Settlement, p. 11. Thus, during the Rate Cap Period, where there is no other opportunity for a cost-based rate adjustment, the MECO Rate Plan addressed the "effect" of a wide range of tax changes based upon this exogenous cost provision.

Importantly, a comparison should properly be made to the second stage of the MECO Rate Plan, namely the so-called "Rate Index Period." Massachusetts Electric, D.T.E. 99-47; MECO Rate Plan Settlement, p. 17. During the period from March 1, 2005 through December 31, 2009, MECO's rates shall be adjusted in a manner more similar to the Company's PCM Plan. Specifically, MECO's distribution rates are subject to annual adjustments based upon an index of the rates of specified utilities in the northeastern United States. Given this adjustment factor for "overall" operating cost, the ability to make exogenous cost adjustments for tax matters was also modified. During the Rate Index Period adjustments for tax, accounting and certain other mandates are allowed only if such changes "are unique to Massachusetts and do not affect other utilities in the Regional Index in a similar way." MECO Rate Plan Settlement, p. 19.

The Company's PCM Plan appears to be more similar to the terms and conditions relating to the MECO Rate Plan's "Rate Index Period's" application of a rate adjustment formula. While providing for an inflation-based annual rate adjustment (after a 31-month rate

freeze), exogenous factor adjustments are available to “positive or negative cost changes actually beyond the Company’s control and not reflected in the GDP-PI, including, but not limited to, cost changes resulting from: changes in tax laws that uniquely affect the local gas distribution industry” Berkshire Gas, D.T.E. 01-56, pp. 25-26.

Berkshire continues to believe that changes to the Internal Revenue Code are fully beyond the control of the Company and adjusting rates for these changes would not affect the strong incentives associated with the PCM Plan. Accordingly, to the extent the Department concludes that some change to the Company’s distribution rates is appropriate in order to reflect a temporary timing difference resulting from Bonus Depreciation availability, an exogenous factor adjustment should only be allowed with the understanding that other tax changes during the term of the PCM Plan shall similarly be an appropriate subject for an adjustment.

In sum, the Company’s PCM Plan adjustment filing properly calculated the amount of the permissible rate adjustment and, ultimately, presented a rate design consistent with the Department’s order in D.T.E. 01-56. The Company does not believe that the application of Bonus Depreciation is a proper subject for an exogenous factor adjustment as it relates, at most, to plant changes. Berkshire, however, would be amenable to such an adjustment should be made with the understanding that future tax changes, resulting in either an increase or a decrease to tax cost, would be reflected similarly in the Company’s rates. Accordingly, the Company respectfully requests that the Department approve the Company’s First Annual PCM Plan

adjustment filing and revised rate design.

Respectfully submitted,

THE BERKSHIRE GAS COMPANY

By its attorneys,

James M. Avery, Esq. (BBO #542672)
Brown Rudnick Berlack Israels LLP
One Financial Center
Boston, MA 02111
Tel.: 617-856-8112
Fax: 617-856-8201

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